

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508, Room 6417 - TE/GE
Cincinnati, OH 45201

Date: SEP 10 2002

Employer Identification Number:
[REDACTED]

Person to Contact - I.D. Number:
[REDACTED]

Contact Telephone Numbers:

Phone
[REDACTED]

FAX
[REDACTED]

Dear Sir or Madam:

We have considered your application for [REDACTED] of exemption from Federal income tax under the provision of section 501(c)(3) of the Internal Revenue Code of 1986 and its Regulations. Based on the available information, we have determined that you do not qualify for the reason stated in Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

[REDACTED]
[REDACTED]

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,



Director, Exempt Organizations

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Publication 892
Form 6018

Enclosure I

FACTS

Your organization was incorporated in [REDACTED] as a nonprofit corporation on [REDACTED].

Article 3 of your Articles of Incorporation lists the following purposes:

The corporation shall be operated exclusively for scientific, educational and charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (or the comparable provision of any future federal Internal Revenue Law) (the "Code"). The specific purposes of the corporation shall be as follows:

1. To develop and implement educational services and seminars which disseminate knowledge that can improve social and human conditions;
2. To cooperate with governmental entities and other nonprofit organizations and agencies to provide affordable and cost-effective educational services;
3. To disseminate such knowledge through low cost, effective and innovative educational formats;
4. To assist in transferring knowledge obtained through research to programs involved in improving social and human conditions so that such knowledge is used and feedback on the usefulness of such knowledge is obtained;
5. To enhance and improve the educational process of research programs involved in improving human and social conditions;

Article 5 of your Articles of Incorporation and Article 2 of your Bylaws state that your organization will have no voting members.

Article 6 of your Articles of Incorporation states that the initial directors of the corporation will be [REDACTED], [REDACTED], [REDACTED], and [REDACTED].

[REDACTED] percent of your organization's time is spent arranging an annual conference for the [REDACTED] (REDACTED). You have contracted with the [REDACTED] to provide an annual conference. To successfully complete the conference arrangements, you engage in the following specific

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activities:

• [REDACTED]

1. Development of a working document outlining decisions to be made by the [REDACTED] planning committee
2. Includes establishing registration fees; exhibit fees; overall budget; timeline; conference schedule; publicity and promotion; development of mailing lists; continuing education credits; scholarship program; logistics, etc...
3. Through this [REDACTED], monies are provided for approximately 40% of the costs to execute the conference. The organization is responsible for raising additional funds (60%) to support the balance of other costs. This is done through registration fees, exhibit fees, sponsorships, scholarship funds, and advertising sales.
4. The [REDACTED] also contains overall policies made for the conference.

• Hotel

1. Obtain and review site proposals
2. Perform site inspections
3. Provide report to [REDACTED] committee for hotel selection
4. Negotiate hotel contracts
5. Monitor room block with hotel
6. Coordinate room set-ups and arrangements
7. Select menus within budgetary guidelines
8. Review and sign banquet event orders finalizing all meeting arrangements
9. Handle on-site management of logistics with hotel personnel

• Registration

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1. Receive registrations by mail, phone, fax, and web
2. Process registration fees received by check, money order, or credit card (Visa, MasterCard and Discover)
3. Enter registrations into customized database that tracks registration data, including event and workshop sign-ups
4. Send registration promptly upon processing registration
5. Design and proofread computer-generated name badges
6. Prepare materials for conference packets, including design and printing of packets and name badge inserts
7. Stuff registration packets with all necessary conference materials and inserts and expedites check-in
8. Handle onsite registration including credit card payments and name badge printing
9. Prepare detailed reports on registration statistics both before and after conference

• Exhibits

1. Develop and maintain mailing list on potential exhibitors
2. Write and design exhibit prospectus and mail to past and prospective organizations
3. Receive exhibitor payments and enter into database
4. Assign booth spaces
5. Coordinate logistics in advance and onsite
6. Serve as liaison between [REDACTED] committee and exhibitors to handle questions, comments and concerns
7. Contract and coordinate with bookstore to obtain books for sale at conference on related topics

• Program and Speakers

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1. Work with [REDACTED] to send a Call for Papers to resource people for submitting proposals for presentations at the conference. Responsibility includes organizing these in a database for the Program Committee
 2. Mail speaker confirmation letters and contracts and follow up for return thereof, ensuring that necessary copyright laws are addressed and explained
 3. Arrange for speaker audiovisual needs
 4. Obtain speaker biography and session description for promotion and on-site program booklet
 5. Track speaker remuneration and prepare speaker checks
 6. Ensure that speaker travel and lodging arrangement, if needed
- Accounting
 1. Develop and monitor budgets and prepare financial projections
 2. Arrange for conference checking and money market accounts with local bank
 3. Process accounts payable and accounts receivable
 4. Obtain approval from bank and make arrangements for credit card processing for registration and exhibitor payment (Mastercard, Visa and Discover)
 5. Provide monthly financial statements, including balance sheet, income statement, comparison to budget and any other financial reports requested
 6. Process credit card payments and make deposits
 7. Provide invoices as required for purchase orders and follow through with collections
 - Computer and Production Services
 1. Copy, write and design forms, brochures, news releases, flvers etc...

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2. Write and develop customized databases for registrations, speakers, exhibitors and mailing lists
3. Design web site for conference promotion and registration
- Other
 1. Develop and ensure timelines are met
 2. Arrange for continuing education credits
 3. Develop mailing lists for publicizing meetings, as required
 4. Design conference evaluation form and prepare detailed post-conference evaluation report(s)
 5. Organize scholarship program logistics
 6. Coordinate logistics with all suppliers, including audiovisual, entertainment, registration personnel, tours and other activities etc...

Your organization subcontracts with [REDACTED] for labor and costs to perform the services required for the [REDACTED] conference. [REDACTED] recently changed its name from [REDACTED]. [REDACTED] is an independent organization engaged in the business of planning and managing conferences, meetings, trade shows, expositions, special events, and the like for various organizations. [REDACTED] was formed in 1979 and has held the [REDACTED] contract since [REDACTED] when the first [REDACTED] conference was conducted. Two of the three directors of [REDACTED] are officers and directors of [REDACTED]. [REDACTED] serves as the [REDACTED] and [REDACTED] [REDACTED] and also serves as the [REDACTED], [REDACTED] [REDACTED] [REDACTED] S. [REDACTED], mother of M. [REDACTED], is the [REDACTED] and S. [REDACTED] and also serves as the S. [REDACTED] and [REDACTED]

For the year [REDACTED] fees paid by your organization to [REDACTED]
[REDACTED], [REDACTED] will represent [REDACTED] % of [REDACTED]
annual gross income.

Your organization will pay [REDACTED] a flat fee of

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\$[REDACTED] for hours worked by [REDACTED] employees on the organization's conference. In addition, you will pay an overhead fee of \$[REDACTED] which covers [REDACTED], [REDACTED] costs for rent, overhead, computer services, base telephone service and routine office supplies. You will also reimburse [REDACTED], [REDACTED] for ordinary and necessary business expenses.

Ten percent of your organization's total time will be spent working with the [REDACTED]. You plan to consult with the [REDACTED], a nonprofit organization dedicated to organizing professional education and training exchanges and furthering economic cooperation between the [REDACTED] region of the U.S. and [REDACTED]. You may assist the [REDACTED] in conducting an annual [REDACTED] each year leading to the [REDACTED] to be held in [REDACTED]. Currently, the [REDACTED] has no funding for future conferences, so it is not anticipated that your organization will contract with [REDACTED] to provide services for the [REDACTED]. To date your organization has been providing services to the [REDACTED] at no charge. Your organization may assist the [REDACTED] with locating charitable sponsorships.

Your organization is funded through [REDACTED] contract fees as well as gross receipts from exhibit fees and registration fees associated with the [REDACTED] contract.

Your expenses consist of overhead, bank and credit card fees, computer services, evaluation, food and beverage, gifts and awards, office supplies and expenses, postage, shipping and delivery, printing and copying, professional accounting services, professional services - planner's fees, publicity and promotion, rental fees for meeting rooms, exhibitors, and audio-visual equipment, speaker's fees, sponsorship consultant, support services, telephone, fax, web, and travel - conference staff. Of the fees listed above, the following are fees that will be paid by your organization to [REDACTED] for the 2002 conference:

- a. Computer Services
- b. Printing and copying (75%)
- c. Professional services - planner's fee
- d. Support services
- e. Telephone, fax and web
- f. Travel - conference staff

\$ [REDACTED]
 \$ [REDACTED]
 \$ [REDACTED]
 \$ [REDACTED]
 \$ [REDACTED]
 \$ [REDACTED]

Total

\$ [REDACTED]

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During the year [REDACTED], approximately [REDACTED] percent of your organization's total expenses will be paid to [REDACTED] for services provided in carrying out the [REDACTED] conference.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable and educational purposes.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for one or more 501(c)(3) purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly, by such private interests.

Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), held that the presence of a single nonexempt purpose, if substantial in nature, will preclude tax exemption under section 501(c)(3) of the Code.

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In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989), the Tax Court considered the qualification for exemption under section 501(c)(3) of the Code of a nonprofit corporation that conducted continuing medical education tours. The petitioner had three trustees. Mr. Helin, who was a shareholder and the president of H & C Tours, a for profit travel agency. Mr. Regan, an attorney, and a third director who was ill and did not participate. Mr. Helin served as executive director. The petitioner used H & C Tours exclusively for all travel arrangements. There is no evidence that the petitioner ever sought a competitive bid. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It concluded that:

When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if it furthers other exempt purposes.

We find that a substantial purpose of petitioner's operations was to increase the income of H & C Tours. H & C Tours benefits from the distribution and production of brochures which solicit customers for tours arranged by H & C Tours. Approximately 90 percent of petitioner's total revenue for 1977 was expended on production and distribution of brochures. The terms of the Travel Service and Administrative Support Agreement further insured that H & C Tours would substantially benefit from petitioner's operations. Petitioner did not solicit competitive bids from any travel agency other than H & C Tours.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), several for-profit est organizations exerted significant indirect control over est of Hawaii, a nonprofit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the nonprofit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion that est of Hawaii did not qualify as an organization described in section 501(c)(3) of the Code.

In Church by Mail, Inc. v. Commissioner (1985), the Court affirmed a Tax Court decision (T.C. 1984-349). Church by Mail sent out sermons in numerous mailings. This required a great deal of printing services.

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Twentieth Century Advertising Agency provided the printing and mailing. Twentieth Century was controlled by the same ministers. It also employed family members. The services were provided under two contracts. The contracts were signed by the two ministers for both Church by Mail and Twentieth Century. Church by Mail business comprised two-thirds of the business of Twentieth Century. In deciding for the government, the Court made the following statement:

There is ample evidence in the record to support the Tax Court's finding that the Church was operated for the substantial non-exempt purpose of providing a market for Twentieth's services. The employees of Twentieth spend two-thirds of their time working on the services provided to the Church. The majority of the Church's income is paid to Twentieth to cover repayments on loan principal, interest, and commissions. Finally, the potential for abuse created by the ministers' control of the Church requires open and candid disclosure of facts bearing upon the exemption application. Moreover, the ministers' dual control of both the Church and Twentieth enables them to profit from the affiliation of the two entities through increased compensation.

APPLICATION OF LAW

Section 501(c)(3) of the Code sets forth two main tests for qualification for tax exempt status. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). You have satisfied the organizational test.

To satisfy the operational test, you must be operated exclusively for one or more exempt purposes. You will not be "operated exclusively for one or more exempt purposes" as set forth in sections 1.501(c)(3)-1(c) and 1.501(c)(3)-1(d)(1)(ii) unless your net earnings do not inure in whole or in part to the benefit of any private shareholders or individuals. The organization must establish that it is serving a public rather than a private interest.

It is our understanding that your organization's board is controlled by the for-profit, [REDACTED]. Your organization is contracting with [REDACTED] to carry out the activities of your organization. This contract is not negotiated at "arms length" based on a competitive bidding process.

Your organization's relationship with [REDACTED] serves the private interests of your board members, [REDACTED]. Further, the net earnings of your corporation are inuring [REDACTED].

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to the benefit of [REDACTED] and [REDACTED], and their corporation, [REDACTED]

Your organization was created by [REDACTED], [REDACTED], is controlled by [REDACTED], and serves the private interests of [REDACTED]

The presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945). Like the Better Business Bureau of Washington D.C., Inc., your organization is also furthering a substantial non-exempt purpose. Your organization is substantially involved in furthering the private interests of your board members, [REDACTED] and [REDACTED] and their corporation, [REDACTED]. This single nonexempt purpose destroys your organization's claim for exemption under section 501(c)(3) of the Code.

You are similar to the organization described in International Postgraduate Medical Foundation v. Commissioner, supra, because [REDACTED], [REDACTED] and, by extension, [REDACTED] and [REDACTED] benefit substantially from the manner in which the activities of [REDACTED] are carried on. The same Board of Directors control both [REDACTED], [REDACTED] and [REDACTED]. [REDACTED] and [REDACTED] hold a majority vote on the Boards of Directors for both corporations. Both [REDACTED] and [REDACTED] are privately benefiting from the operation of [REDACTED].

In order for private benefit to be present it is not required that payments for goods or services to Kornelsen Associates, Inc. be unreasonable or exceed fair market value. In est of Hawaii, the Tax Court stated:

"Nor can we agree with petitioner that the critical inquiry is whether the payments made to International were reasonable or excessive. Regardless of whether the payments made by petitioner to International were excessive, International and EST, Inc., benefited substantially from the operation of petitioner."

Also, in Church by Mail, supra, the Church argued that the compensation to the for-profit was reasonable. The Court's statement on the subject is very significant. The Church exaggerates the importance of the contracts. The critical inquiry is not whether

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particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit benefits substantially from the operation. Like Church by Mail, your organization's entire enterprise is carried on in such a manner that the for-profit, [REDACTED], [REDACTED], benefits substantially from the operation of your organization.

TAXPAYER'S POSITION

Your letter dated [REDACTED], outlines the position of your organization with regard to qualification for tax exemption under section 501(c)(3) of the Code. You indicate that your organization qualifies for tax exemption under section 501(c)(3) because the activities conducted by your organization are exclusively educational. You indicate that the only activity conducted by your organization is providing educational conferences to deal with issues of relevance to the community. Currently, your organization is working on educating the public on the prevention and treatment of alcohol and drug abuse and organizing educational training and exchange between [REDACTED] and the [REDACTED] region of the U.S. You insist that the charitable and educational nature of your activities is demonstrated by the fact that you solicit donations and use these funds to pay for low-income individuals to attend your conference. During the [REDACTED] conference, you indicated that [REDACTED] of the attendees were at-risk teenagers who attended for free.

Further, you draw similarities between your organization and other educational institutions. Like other educational organizations, your organization must pay a staff to carry out your educational activities. As an educational organization might pay the employees of a school district, your organization is simply contracting with [REDACTED] to carry out the logistics of providing these educational opportunities to the community. You go on to state that the fees paid to [REDACTED] to provide services are set by the [REDACTED] or the [REDACTED] in advance of awarding the contract and that these organizations utilize a competitive bidding process to set fees. You indicate that the fees paid to [REDACTED] are not set at fair market value, but rather, set within the fee structure of the [REDACTED]. You make the argument that the organization accepts fees on a sliding scale based on the organization's ability to pay. You substantiate this argument by stating that the request for proposal, submitted to the [REDACTED] annually, indicates that if the amount of revenue for the conference is less than the expenses, then fees paid to subcontractors must be lowered.

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You have also indicated that to provide the annual conference for the [REDACTED], all requests for proposals must be submitted by a nonprofit corporation, local governmental unit, or a post-secondary institution. In addition, you explain that the [REDACTED] recognizes that for-profit corporations may be contracted with to provide their annual conference.

Finally, you explain that your organization is not providing commercial meeting planning services on a fee basis. You indicate that your organization is not in the meeting planning business, but you must engage a meeting planning business to carry out your tax exempt purpose.

IRS POSITION

Your letter dated May 21, 2002, asserts that the organization qualifies for tax exemption under section 501(c)(3) of the Code because all activities conducted by your organization are in furtherance of educational purposes and all dealings with [REDACTED] are at arms length.

We disagree with your assertions. We hold that your organization does not meet the requirements of section 501(c)(3) of the Code because you serve a private rather than a public purpose. Based on the information submitted, it is clear that the board of [REDACTED], a for-profit corporation, exercises control over your organization. The officers and directors of [REDACTED] represent the majority of officers and directors of your organization. There has been no information submitted to date to establish that your organization's business dealings with [REDACTED] are carried on at arms length. You indicate that the [REDACTED] awards contracts which take into account a competitive bidding process, however, you have not established that [REDACTED] was awarded the contract with your organization based on a competitive bidding process. There is no evidence indicating that your organization contacted other meeting planning companies to solicit bids before awarding the contract to [REDACTED].

Since [REDACTED] and its predecessor have been contracting with the [REDACTED] to provide the [REDACTED] and [REDACTED]. Since [REDACTED] can only contract with a nonprofit organization, local governmental unit, or a post-secondary institution to conduct the conference, your corporation was created. Essentially,

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your organization serves as a conduit that allows [REDACTED] to continue contracting with the [REDACTED] to provide professional meeting and planning services. Your organization was created by [REDACTED], is controlled by [REDACTED], and serves the private interests of [REDACTED]. As a result, you are precluded from qualifying for tax exemption under section 501(c)(3) because you are serving the private interests of your board members, [REDACTED] and [REDACTED], and their corporation, [REDACTED].

When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if it furthers other exempt purposes. International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989).

In accordance with est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), tax exemption under section 501(c)(3) is precluded because [REDACTED] benefited substantially from the operation of your organization.

As stated in Church by Mail, Inc. v. Commissioner (1985), the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit benefits substantially from the operation.

CONCLUSION

Based on the facts presented above, we hold that your organization does not meet the requirements for tax exemption under section 501(c)(3) of the Code because you do not meet the operational test outlined in section 1.501(c)(3)-1(c) of the Regulations.

This section of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if its net earnings

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inure in whole or in part to the benefit of private shareholders or individuals.

Based on the facts that you have provided in your application for recognition of exemption, it is clear that your organization's net earnings inure to [REDACTED] and [REDACTED] and to their corporation, [REDACTED]. As a result, we are not able to conclude that you are operated exclusively for public rather than private purposes. Despite any charitable purposes your activities may achieve, you cannot qualify for exemption because more than an insubstantial part of your activities is not in furtherance of exempt purposes.

Accordingly you do not qualify for exemption under section 501(c)(3) of the Code because you do not meet the proscriptions in sections 1.501(c)(3)-1(c)(2) and 1.501(c)(3)-1(d)(1)(ii) of the Regulations.